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# Commercial Transactions

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# COMMERCIAL TRANSACTIONS

by  
*John Krahmer\**

THE 1985 survey period was an active one in Texas commercial law.<sup>1</sup> Legislative changes, as well as significant court decisions, contributed to the developments covered in this Survey. For organizational purposes and ease of reference, the discussion parallels the chapter arrangement of the Texas Business and Commerce Code.<sup>2</sup>

## I. GENERAL PROVISIONS—ACCELERATION AND PREPAYMENT CLAUSES

While the right of a creditor to accelerate a debt has been clearly established in Texas for several years,<sup>3</sup> the method of accelerating a debt has been the subject of frequent litigation.<sup>4</sup> During the 1985 survey period the

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1. A survey period includes cases reported in the Southwestern Reporter Advance Sheet from October 15th of one year to October 15th of the following year. These dates are chosen to meet publication deadlines. A few cases that are decided late in the year, therefore, are not reported by West Publishing Company until the survey period has closed. This explains the 1984 decision date on a few of the cases discussed in this survey.

2. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.08 (Tex. UCC) (Vernon 1968 & Supp. 1986). The chapters in the Code are organized as follows: Chapter 1, General Provisions; Chapter 2, Sales; Chapter 3, Commercial Paper; Chapter 4, Bank Deposits and Collections; Chapter 5, Letters of Credit; Chapter 6, Bulk Sales; Chapter 7, Documents of Title; Chapter 8, Investment Securities; and Chapter 9, Secured Transactions.

3. The Uniform Commercial Code first became effective in Texas on July 1, 1966. Uniform Commercial Code, ch. 721, §§ 1-101 to 10-105, 1965 Tex. Gen. Laws 1. In 1967 it became part of the Texas Business and Commerce Code. Texas Business and Commerce Code, ch. 785 §§ 1-6, 1967 Tex. Gen. Laws 2343-2621. Section 1.208 of the Code, authorizing the use of acceleration clauses, has been in effect for almost 20 years. See TEX. BUS. & COM. CODE ANN. § 1.208 (Tex. UCC) (Vernon 1968).

4. See, e.g., *Ogden v. Gilbralter Sav. Ass'n*, 640 S.W.2d 232, 233-34 (Tex. 1982) (holder failed to give unequivocal notice of intent to accelerate); *Slivka v. Swiss Ave. Bank*, 653 S.W.2d 939, 940-41 (Tex. App.—Dallas 1983, no writ) (maker expressly waived notice of intent to accelerate and notice of acceleration); *Bodiford v. Parker*, 651 S.W.2d 338, 339 (Tex. App.—Fort Worth 1983, no writ) (holder failed to give any notice of intent to accelerate); *Highpoint of Montgomery Corp. v. Vail*, 638 S.W.2d 624, 626-27 (Tex. App.—Houston [1st Dist.] 1982, no writ) (creditor's acceptance of late payments does not waive future rights to accelerate; any notice of intent to accelerate for future default must be unequivocal); *McGowan v. Pasol*, 605 S.W.2d 728, 732 (Tex. Civ. App.—Corpus Christi 1980, no writ) (creditor's acceptance of late payments does not waive future right to accelerate; holder must give notice of future intent to accelerate). Four more acceleration cases under the Code were reported during the Survey period: *Cruce v. Eureka Life Ins. Co.*, 696 S.W.2d 656, 57 (Tex. App.—Dallas 1985, no writ) (contractual waivers of notice are enforceable); *Baldazo v. Villa Oldsmobile, Inc.*, 695 S.W.2d 815, 817 (Tex. App.—Amarillo 1985, no writ) (reviewing procedures for acceleration); *Emfinger v. Pumpco, Inc.*, 690 S.W.2d 88, 90 (Tex. App.—Beaumont 1985, no writ) (note expressly waived notice of intent to accelerate notwithstanding late payments); *Velde v.*

Amarillo court of appeals outlined the basics of acceleration law in *Baldazo v. Villa Oldsmobile, Inc.*<sup>5</sup> The court stated that

if a secured promissory note grants the holder an option to accelerate the note upon the maker's default, equitable principles require the holder to give notice of several events. The holder must make presentation of the note and demand payment of all past due installments prior to acceleration. The holder must further advise the maker that acceleration will occur and the entire balance will be due and payable if the maker fails to cure the delinquency.

If payment of the delinquency is not forthcoming, the holder must give the maker notice that acceleration has occurred. Once notice is served the debtor can no longer cure the default. The entire debt becomes due and payable.<sup>6</sup> The *Baldazo* court emphasized that the above sequence of notices must be followed. According to these prescriptions "[N]otice that the debt has been accelerated has no legal effect unless preceded by notice that the debt will be accelerated."<sup>7</sup>

Beyond the basics, the principal issue that is developing in the Texas law of acceleration involves the validity of waivers of the right to notice of an intent to accelerate and the right to notice of acceleration. A split in the judicial approach toward this issue may be occurring, and an analysis of the evolution of the waiver concept is instructive in analyzing this split. In *Ogden v. Gilbralter Savings Association*<sup>8</sup> the Texas Supreme Court discussed the sequence of required notices at some length. The word waiver appears twice in this discussion, not as the direct focus of the court's discussion but instead as a parenthetical aside, describing a possible alternative to the giving of the required notices.<sup>9</sup> This brief mention, however, served as the basis of decision in subsequent cases finding a debtor had waived the right to notice of intent to accelerate, to notice of acceleration, or to both.<sup>10</sup> This line

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Swanson, 679 S.W.2d 627, 629 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) (holder called demand notes on comakers death; case decided under Nebraska law).

5. 695 S.W.2d 815 (Tex. App.—Amarillo 1985, no writ).

6. *Id.* at 817.

7. *Id.* (citations omitted). In *Baldazo* the court held that the single notice sent to the debtor by the creditor was not adequate notice of an intent to accelerate the debt, because the only reference to acceleration was a statement that "[i]f the sale price is less than the total amount you owe, *you still owe the rest.*" [Emphasis in original.] *Id.* The creditor may have been lulled into believing that this notice was adequate, because the debtor had voluntarily surrendered the collateral after missing several payments. The creditor may have also relied on the fact that the content of the notice focused on the disposition of the collateral pursuant to a private sale, as required by TEX. BUS. & COM. CODE ANN. § 9.5049(c) (Tex. UCC) (Vernon Supp. 1986). The court, however, was very clear on the point that a notice of intent to accelerate was required. The court of appeals reversed the trial court and rendered a take-nothing judgment against the creditor. *Id.* See also *Williamson v. Dunlap*, 693 S.W.2d 373, 374 (Tex. 1985) (denying right to accelerate when no notice of intent to accelerate was given).

8. 640 S.W.2d 232 (Tex. 1982).

9. *Id.* at 233-34. In both instances the word "waiver" appears as part of a parenthetical phrase. In highly edited form the statement by the Court was that "in the absence of a waiver, the holder . . . must . . . demand payment . . . prior to exercising his right to accelerate . . . Proper notice that the debt has been accelerated, in the absence of a contrary agreement or waiver, cuts off the debtor's right to cure his default . . ." *Id.* 233-34.

10. See, e.g., *Real Estate Exch., Inc. v. Bacchi*, 676 S.W.2d 440, 441 (Tex. App.—Houston [1st Dist.] 1984, no writ) (right to notice of acceleration waived; no duty to give notice of

of cases applies a literal interpretation of *Ogden* without inquiry into the underlying policy of the case. In the latest case of this series reported during the survey period, *Cruce v. Eureka Life Insurance Co.*,<sup>11</sup> two of the three judges found a waiver based on the literalist approach,<sup>12</sup> but the third judge wrote a vigorous dissent<sup>13</sup> based on a policy analysis of *Ogden*<sup>14</sup> and its predecessors.<sup>15</sup> Under this analysis the notice requirements surrounding acceleration are of equitable origin and are not subject to contractual waiver.<sup>16</sup> According to the dissent the notice requirements help protect a debtor against forfeiture by giving a meaningful opportunity to cure defaults before acceleration is declared and a foreclosure takes place.<sup>17</sup> This analysis renders the mention of waiver in *Ogden* dictum because the creditors had not made any claim of waiver before the court.<sup>18</sup> As an alternative ground to set aside a foreclosure, the dissent also urged that the courts should construe strictly against the lender any waiver contained in a lending agreement.<sup>19</sup> Additionally, any waiver should meet the *Ogden* test of clear and unequivocal language by bringing home to the debtor effective knowledge of the rights he has waived.<sup>20</sup> The dissent would hold that the language used in the waiver clause before the court was inadequate to meet this standard.<sup>21</sup>

Although one dissent does not clearly establish a trend, a thorough review and careful analysis of the concepts of effective waiver make the dissenting opinion a persuasive one and may herald a new line of lower appellate court

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intent to accelerate); *Cortez v. Brownsville Nat'l Bank*, 664 S.W.2d 805, 810 (Tex. App.—Corpus Christi 1984, not writ) (notice of intent to accelerate waived in note); *Chapa v. Herberster*, 653 S.W.2d 594, 601 (Tex. App.—Tyler, 1983, no writ) (notice of acceleration dispensed with if waived in note).

11. 696 S.W.2d 656 (Tex. App.—Dallas 1985, no writ).

12. *Id.* at 657.

13. *Id.* (Howell, J., dissenting).

14. *Id.* The *Ogden* test embodies the policy that a contractual waiver cannot stay the hand of equity.

15. The predecessors were *Allen Sales & Servicenter, Inc. v. Ryan*, 525 S.W.2d 863, 864-66 (Tex. 1975) (discussing historical basis for presentment prior to optional acceleration) and *Faulk v. Futch*, 147 Tex. 253, 214 S.W.2d 614, 616 (1948) (requirement of presentment imposed for protection of maker).

16. 696 S.W.2d at 657 (Howell, J., dissenting).

17. *Id.* at 659.

18. *Id.* at 661.

19. 696 S.W.2d at 662-63 (Howell, J., dissenting).

20. *Id.*

21. *Id.* at 664. The waiver in the note said, "each maker, surety and endorser of this note expressly waives all notices, demands for payments, notices of intention to accelerate the maturity protest and notice of protest, as to this note and as to each, every and all installments hereof." *Id.* at 656. The waiver clause in the deed of trust said:

That in the event of default in the payment of any installment, principal or interest of the note hereby secured, in accordance with the terms thereof, or of a breach of any covenants herein contained to be performed by grantors, then and in any such events beneficiary may elect, grantors hereby expressly waiving presentment and demand for payment, to declare the entire principal indebtedness hereby secured with all interest accrued thereon and all other sums hereby secured immediately due and payable . . . .

*Id.* at 656-57. The author believes the dissent had a good point. The language used in these waivers hardly seems calculated to bring home to the debtor very much of anything but a collection of legalese.

cases less willing to find waivers of rights to notification. No reported Texas case has discussed a middle ground in the area of acceleration and waiver. Under the default provisions of Chapter 9 of the Code,<sup>22</sup> certain rights of the debtor can only be waived after a default has occurred.<sup>23</sup> The right of redemption<sup>24</sup> is one of the rights singled out for this special treatment, and it would not be illogical to hold that a right to notice of intent to accelerate is sufficiently akin to the right to redemption to justify similar treatment. Even if *Ogden* is read literally, nothing in that opinion discusses the proper time for waiver. The literalist line of cases has not addressed the issue of timing, apparently on the assumption that a pre-default contractual waiver can be fully effective. In addition to raising the arguments made by the dissent in *Cruce*, a debtor might do well to raise the possibility of post-default waiver as an equally literal interpretation of *Ogden*.

A problem often related to acceleration is whether the acceleration clause used in an instrument purports to allow the collection of unearned interest in violation of the Consumer Credit Code.<sup>25</sup> In *Yates Ford, Inc. v. Ramirez*<sup>26</sup> the supreme court settled the question whether interest rates calculated on the basis of a thirty-day month instead of the number of actual days in a given month violated the Consumer Credit Code.<sup>27</sup> In the five cases consolidated in *Yates* the overcharge ranged from a low of \$.09 to a high of \$3.10. The court held that although each contract technically violated the Consumer Credit Code, the *de minimus* doctrine applied to the overcharges because they resulted from a "slight error in calculating the finance charges under a highly technical statute"<sup>28</sup> and not from "an unscrupulous scheme to defraud citizens."<sup>29</sup> A concurring opinion criticized the use of the *de minimus* theory on the ground that the Consumer Credit Code is a penal statute the courts should construe strictly and refrain from blurring the bright line created by the legislature.<sup>30</sup> According to the concurrence, a court could achieve the result reached by the majority through application of the Annual Percentage Rate formulas approved by the Consumer Credit

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22. TEX. BUS. & COM. CODE ANN. §§ 9.501-.507 (Tex. UCC) (Vernon Supp. 1985).

23. See, e.g., *id.* §§ 9.504 (after default debtor may waive right to notice of sale); 9.505 (imposing duties on seller as to disposition of collateral if debtor has not waived rights after default); 9.506 (unless waived debtor may redeem collateral after default).

24. *Id.* § 9.506 (Tex. UCC) (Vernon Supp. 1985).

25. TEX. REV. CIV. STAT. ANN. art. 5069—1.01 to 5069—15.08 (Vernon 1971 & Supp. 1986). The Texas Consumer Credit Code is not a true code since it is not part of the official Texas codifications, but it has acquired this name by popular usage. The acceleration clause problem referred to in the text is reviewed at some length in *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d 324, 328-32 (Tex. 1984).

26. 692 S.W.2d 51 (Tex. 1985).

27. This method of calculation is sometimes called "odd-days" calculation. The "odd days" problem arises from a difference in the manner of calculating a month under TEX. REV. CIV. STAT. ANN. art. 5069—2.01(j) (Vernon 1971 & Supp. 1986) as compared to the manner of calculating a month under the federal Truth in Lending Act as provided in 12 C.F.R. § 226(b)(5)(ii) (Appendix J) (1985). Mathematically inclined readers who have a computer and spreadsheet software can spend many happy hours playing with the differences in the calculations.

28. 692 S.W.2d at 55.

29. *Id.*

30. *Id.* at 55 (Kilgarlin, J., concurring).

Code<sup>31</sup> and the federal Truth in Lending Act.<sup>32</sup> Calculation pursuant to these formulas revealed that the creditor charged less than the maximum allowed under the Consumer Credit Code on all five contracts.<sup>33</sup> Use of the concurring judge's suggested method would have avoided the uncertainties inherent in application of the *de minimus* doctrine.

## II. SALES TRANSACTIONS

### A. Enforceability of Sales Contracts

1. *Statute of Frauds: Burden of Showing Exceptions.* The general rule under section 2.201 of the Code is that a contract for the sale of goods for the price of \$500.00 or more is not enforceable unless a writing exists that is sufficient to show that the parties have made a contract of sale that is signed by the party against whom the other party seeks enforcement.<sup>34</sup> Despite this general rule, a contract for the sale of goods may be enforceable if the case fits within one of the exceptions stated in the same section.<sup>35</sup> In two cases decided during the Survey period aggrieved buyers sought to enforce oral contracts for the sale of goods.<sup>36</sup> In one of the cases the court held that the buyer had the burden of requesting the submission of special issues that would bring the case within an exception to the statute of frauds.<sup>37</sup> The buyer's failure to request any special issues on the matter was fatal to the claim of an enforceable oral agreement.<sup>38</sup> In the other case the buyer successfully resisted a motion for summary judgment by submitting an affidavit alleging that the seller had accepted, indorsed, and deposited a \$1500 check issued in part payment for a truck trailer.<sup>39</sup> The buyer attached a copy of the cancelled check to the affidavit and noted on the check that it was issued for a forty foot trailer. The court held that the affidavit and attachment were sufficient to raise a genuine issue of material fact and denied summary judgment.<sup>40</sup>

2. *Parol Evidence and the Deceptive Trade Practices Act.* Section 17.46 of the Texas Deceptive Trade Practices Act (DTPA)<sup>41</sup> makes it a deceptive trade practice to represent "that an agreement confers or involves rights, remedies, or obligations which it does not have or involve, or which are

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31. TEX. REV. CIV. ANN. art 5069—7.03(1) Class 1 (Vernon Supp. 1985).

32. 12 C.F.R. § 226(b)(5)(ii) (Appendix J) (1985).

33. 692 S.W.2d at 56-57 (Kilgarlin, J., concurring).

34. TEX. BUS. & COM. CODE ANN. § 2.201 (Tex. UCC) (Vernon 1968).

35. *Id.* § 2.201(c). The exceptions include admissions made in legal proceedings, part performance by delivery and partial payment. *Id.*

36. See *Mitchell v. Jones*, 694 S.W.2d 61 (Tex. App.—Houston [14th Dist.] 1985, no writ), *W.H. McCrory & Co. v. Contractors Equip. & Supply Co.*, 691 S.W.2d 717 (Tex. App.—Austin 1985, writ ref'd n.r.e.).

37. *W.H. McCrory & Co. v. Contractors Equip. & Supply Co.*, 691 S.W.2d 717, 720 (Tex. App.—Austin 1985, writ ref'd n.r.e.).

38. *Id.* at 721.

39. *Mitchell v. Jones*, 694 S.W.2d 61, 63 (Tex. App.—Houston [14th Dist.] 1985, no writ).

40. *Id.*

41. TEX. BUS. & COM. CODE ANN. § 17.41-63 (Vernon Supp. 1986).

prohibited by law."<sup>42</sup> Section 2.202 of the Code allows a party to use parol evidence to supplement the terms of a written agreement when the writing is incomplete in one or more respects.<sup>43</sup> The question that then arises is whether a seller violates the DTPA if he misrepresents rights under a contract in its supplemental parol aspects instead of misrepresenting one of its written aspects. In *Bob Robertson, Inc. v. Webster*<sup>44</sup> the court answered this question affirmatively and held the seller liable for a DTPA violation.<sup>45</sup> The contract in *Bob Robertson* was silent on a delivery date, but the seller had orally promised delivery of goods within ten weeks. Tender of delivery, however, did not occur for more than six months. The court permitted supplementation of the contract by parol evidence to show the promised delivery time of ten weeks and upheld a jury finding that this representation was false.<sup>46</sup>

3. *Assignment of Rights.* In an interesting case involving the negligent failure of the publisher of a Yellow Page Directory to include an ad for a car rental business, the Corpus Christi court of appeals held in *Reuben H. Donnelley Corp. v. McKinnon*<sup>47</sup> that a limitation of liability clause in the advertising contract was ineffective to prevent the recovery of lost profits by the affected business.<sup>48</sup> The court noted that no other Texas court had previously decided the issue in the context of a negligent failure to fulfill an advertising contract.<sup>49</sup> One of the defenses raised by the defendant publisher was an anti-assignment clause in the advertising order form. Since the contracting owner had sold the car rental business after the advertising order was placed, the publisher argued that it had no liability to the assignee of the advertising contract. Although recognizing that the Code is not directly applicable to contracts for advertising services, the court dismissed the anti-assignment clause argument on the ground that both the Restatement (Second) of Contracts<sup>50</sup> and several provisions of the Code<sup>51</sup> permit assignments despite clauses denying the right to assign.<sup>52</sup> Under both the Restatement and the Code, the aggrieved party is entitled to an action for damages, but the assignment is not rendered ineffective.<sup>53</sup> The court held that the advertiser had a duty running to the assignee that would support a claim for negligent failure to provide the Yellow Page advertising.<sup>54</sup>

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42. *Id.* § 17.46(b)(12).

43. *Id.* § 2.202.

44. 679 S.W.2d 683 (Tex. App.—Houston [1st Dist.] 1984, no writ).

45. *Id.* at 689-90.

46. *Id.*

47. *Reuben H. Donnelley Corp. v. McKinnon*, 688 S.W.2d 612 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.).

48. *Id.* at 616.

49. *Id.* at 615.

50. RESTATEMENT (SECOND) OF CONTRACTS § 322(2) (1979).

51. TEX. BUS. & COM. CODE ANN. §§ 2.210, 9.104(6) & 9.318(d) (Tex. UCC) (Vernon 1968 & Supp. 1985).

52. 688 S.W.2d at 615.

53. RESTATEMENT (SECOND) OF CONTRACTS § 322(2) (1979); TEX. BUS. & COM. CODE ANN. § 2.210(5) (Tex. UCC) (Vernon 1968).

54. 688 S.W.2d at 615.

### B. Warranties

1. *Warranties Created by Sample.* Under the Code sellers may create express warranties by affirmation of fact or promise relating to the goods, by description of the goods, or by exhibition of a sample or model.<sup>55</sup> In *Thrall v. Renno*<sup>56</sup> the buyers contracted for the construction of an outdoor brick patio. They selected the brick for the project based on the color of a sample shown to them by the contractor. The contractor constructed the patio by laying the bricks in a sand base. Within a few months the color of the bricks changed from pink to white because of a chemical reaction to water. The patio was also no longer level. The buyers sued for breach of an express warranty regarding the quality of the bricks and for breach of an implied warranty of good and workmanlike installation. The court held that no express warranty was created by exhibition of the sample because the seller had made no representation of the quality of performance of the brick when used as patio brick.<sup>57</sup> Although this conclusion is open to question, the court's decision that the contractor had breached the implied warranty to construct the patio in a good and workmanlike manner rendered the point moot.<sup>58</sup> The court also held that failure properly to construct the patio was an unconscionable action, or course of action, and that the evidence supported the recovery of damages to replace the patio as well as the recovery of attorney's fees.<sup>59</sup> The damages were trebled pursuant to the provisions of the DTPA.<sup>60</sup>

2. *Warranties of Merchantability.* Unless excluded or modified, a warranty of merchantability is implied in every contract for the sale of goods if the seller is a merchant with respect to the goods covered by the contract.<sup>61</sup> In 1980 the Texas Supreme Court held that the protection afforded by the warranty of merchantability extends not only to the buyer, but also to employees of the buyer who are injured by a product that is unfit for the ordinary purposes for which the employees normally use the product.<sup>62</sup> Lack of privity of contract between the employee and the seller was not a bar to warranty recovery.<sup>63</sup> The court in *Bernard v. Dresser Industries, Inc.*<sup>64</sup> applied the rule to permit the recovery of damages by an employee injured by the explosion of a pipeline pressure gauge.<sup>65</sup> The court correctly held that the buyer need not show that the gauge was defective for recovery on a breach of warranty theory.<sup>66</sup>

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55. TEX. BUS. & COM. CODE ANN. § 2.313 (Tex. UCC) (Vernon 1968).

56. 695 S.W.2d 84 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

57. *Id.* at 86.

58. *Id.* at 86-87.

59. *Id.* at 87-88.

60. *Id.* at 85-86. Breach of warranty is made a basis for a DTPA claim under TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Vernon Supp. 1985).

61. TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968).

62. *Garcia v. Texas Instruments, Inc.*, 610 S.W.2d 456, 465 (Tex. 1980).

63. *Id.*

64. 691 S.W.2d 734 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

65. *Id.* at 739.

66. *Id.* at 738.



Although lack of privity does not bar employees from maintaining warranty actions, lack of any contact with the product does operate as a bar in warranty claims asserted by persons whose injuries result from not using the product. In *Church v. Ortho Diagnostic Systems, Inc.*<sup>67</sup> the plaintiffs ingeniously argued that allegedly incorrect warnings concerning use of a drug to counteract Rh positive blood factors during pregnancy constituted a breach of warranty to them. The plaintiffs argued that the attending physicians did not administer the drug to them because of the warnings. The plaintiffs reasoned that the abolition of the privity doctrine,<sup>68</sup> in conjunction with decisions allowing recovery for mental anguish without direct contact,<sup>69</sup> demonstrated that no contact with the product was required to maintain a warranty action. The court held that the abolition of the privity rule did not amount to a rule that no sale was required.<sup>70</sup> A sale to someone affected by the product must still occur.<sup>71</sup> The court further held that the cases allowing recovery for mental anguish dealt with recovery of particular damages as part of a recognized cause of action and not with the creation of action itself.<sup>72</sup> The court summarized its decision by stating, "[W]e hold that no cause of action is created for breach of warranty, where the action complained of is motivated by not buying, using or coming in contact with the product. . . . Appellant's only connection, if any, with the product, was that she didn't use it."<sup>73</sup>

3. *Warranties of Fitness for a Particular Purpose.* The warranty of fitness for a particular purpose differs from the warranty of merchantability in that it does not arise in every sale. The warranty only comes into existence when the seller has reason to know of a particular purpose for which the buyer plans to use the goods and knows that the buyer is relying on the seller's skill or judgment in selecting suitable goods.<sup>74</sup> In *International Armament Corp. v. King*<sup>75</sup> the supreme court found a breach of this warranty in the sale of a shotgun that one could fire despite the engagement of the safety mechanism.<sup>76</sup> Evidence in the case supported a finding that the seller was aware of this design defect, but had deliberately chosen not to warn buyers of this

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67. 694 S.W.2d 552 (Tex. App.—Corpus Christi 1985, no writ).

68. See *Garcia v. Texas Instrument, Inc.*, 610 S.W.2d 456, 465 (Tex. 1980) (privity not a requirement to maintain warranty action for personal injuries).

69. See, e.g., *Sanchez v. Schindler*, 651 S.W.2d 249, 254 (Tex. 1983) (allowing mother to recover for mental anguish resulting from death of son); *Williams v. Steves Indus., Inc.*, 678 S.W.2d 205, 212 (Tex. App.—Austin 1984, writ granted) (allowing mother to recover for mental anguish resulting from death of child); *Gulf States Utilities Co. v. Reed*, 659 S.W.2d 849, 852-53 (Tex. App. Houston [14th Dist.] 1983, writ ref'd n.r.e.) (allowing mother to recover for mental anguish resulting from death of a child).

70. 694 S.W.2d at 555.

71. *Id.*

72. *Id.*

73. *Id.*

74. The requirements for an implied warranty of fitness for a particular purpose appear in TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1968).

75. 686 S.W.2d 595 (Tex. 1985).

76. *Id.* at 599.

problem.<sup>77</sup> The seller had, in fact, distributed a brochure for some time that described the shotguns of this type as being meticulously assembled and machined. The court upheld an actual damage award of \$234,053.60 and a punitive damage award of \$1,500,000 plus attorney's fees based on the evidence in the record.<sup>78</sup>

4. *Warranties in the Sale of Homes.* In *Evans v. J. Stiles, Inc.*<sup>79</sup> the supreme court again addressed the question of warranties that attach to the sale of residential dwellings. Although little doubt existed previously, every sale of a dwelling now clearly includes warranties that the dwelling is fit for human habitation and is constructed in a good and workmanlike manner.<sup>80</sup> The seller can, however, disclaim these warranties.<sup>81</sup> The supreme court held that "[T]he implied warranty of construction in a good workmanlike manner is independent of the implied warranty of habitability; therefore the trial court properly rendered judgment for the Evanses based upon the jury's finding that the house was not constructed in a good workmanlike manner."<sup>82</sup> The supreme court reversed the court of appeals' holding that no breach had occurred because the jury had failed also to find the house uninhabitable and affirmed the judgment of the trial court.<sup>83</sup>

The implied warranties that come into existence in the sale of a dwelling can be disclaimed under Texas law if the disclaimer is "clear and free from doubt."<sup>84</sup> In *McCrea v. Cubilla Condominium Corp.*<sup>85</sup> the court held that a disclaimer was effective when the contract provided that "purchaser has made a physical inspection of the unit and, thus *is taking the unit*, all appliances and utility fixtures and equipment *without warranty from seller, express or implied*. . . ."<sup>86</sup> Fortunately for the buyer, the contract also provided that the seller was not bound by any other representations "unless the same are expressly set forth in this agreement or in a subsequent written agreement executed by seller."<sup>87</sup> The court held that a subsequent letter from the seller

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77. *Id.*

78. *Id.*

79. 689 S.W.2d 399 (Tex. 1985).

80. *Id.* at 400. Earlier cases discussing these warranties include *Gutpa v. Ritter Homes, Inc.*, 646 S.W.2d 168, 169 (Tex. 1983) (builder liable to subsequent purchaser for defects not reasonably discoverable at time of sale); *Humber v. Morton*, 426 S.W.2d 554, 555 (Tex. 1968) (law implies warranties of habitability and construction in good workmanlike manner).

81. 689 S.W.2d at 400; *see also* *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 393 (Tex. 1982) (implied warranties can be waived).

82. 689 S.W.2d at 400.

83. *Id.* In another case involving warranties in the sale of a dwelling, the court of appeals had no difficulty applying the correct warranty standards. *See De Los Santos v. Alamo Lumber Co.*, 683 S.W.2d 48, 51-52 (Tex. App.—San Antonio 1984, no writ).

84. *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 393 (Tex. 1982).

85. 685 S.W.2d 755 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

86. *Id.* at 757 (emphasis added by court). The author has argued elsewhere that the courts should develop stricter standards for the disclaimer of warranties in the sale of a dwelling. *See Krahmer, Commercial Transactions, Annual Survey of Texas Law*, 38 Sw. L.J. 207, 215-16 (1984). At a minimum the law should require that sellers make the disclaimers conspicuous.

87. 685 S.W.2d at 757 (emphasis omitted).

created an express warranty to repair the roof.<sup>88</sup> The court's finding entitled the buyer to try the issue whether the seller had breached the express warranty.<sup>89</sup>

5. *Disclaimer of Warranties.* Although the standards differ sellers clearly may disclaim warranties in the sale of goods and warranties in the sale of homes under current Texas law.<sup>90</sup> A growing number of cases have also held that a disclaimer of warranties can bar a DTPA claim based on breach of warranty.<sup>91</sup> A refinement of this position may be found in *Reliance Universal, Inc. v. Sparks Industrial Services, Inc.*,<sup>92</sup> in which the court held that a warranty disclaimer was not effective to bar a DTPA recovery when the buyer had received favorable jury findings on an independent DTPA claim.<sup>93</sup> In *Reliance* the jury found that the seller had represented that certain goods were of a particular standard, quality, or grade when they were of another; and that the seller had represented the goods to have characteristic ingredients, uses, or benefits that they did not have or involve.<sup>94</sup> The court held that even though a disclaimer might be effective if the action had been brought only as a warranty claim, the disclaimer had no effect on an independent DTPA claim even though the quality of the goods also figured in that claim.<sup>95</sup>

### C. Performance Disputes

1. *Manner of Rejection.* Upon tender of delivery a buyer is entitled to reject goods in whole or in part if they fail in any respect to conform to the contract.<sup>96</sup> A buyer must reject the goods within a reasonable time after delivery.<sup>97</sup> If the buyer receives and retains goods without making an effective rejection, the buyer is deemed to have accepted the goods<sup>98</sup> and must pay at the contract rate for the goods accepted.<sup>99</sup> In *Ho v. Wolfe*<sup>100</sup> the court applied these rules and found that the buyer of a restaurant business had failed to reject effectively a tender of goods when the buyer had received

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88. *Id.* at 760.

89. *Id.*

90. See TEX. BUS. & COM. CODE ANN. § 2.316 (Tex. UCC) (Vernon 1968) (establishing standards for disclaimers in sale of goods); *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 393 (Tex. 1982) (establishing standards for disclaimers in sale of dwellings).

91. See, e.g., *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 393 (Tex. 1982) (disclaimer of implied warranties in sale of dwelling barred DTPA claim); *McCrea v. Cubilla Condominium Corp.*, 685 S.W.2d 755, 757 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) (disclaimer of implied warranties in sale of condominiums not violative of DTPA); *Ellmer v. Delaware Mini-Computer Sys., Inc.*, 665 S.W.2d 158, 161 (Tex. App.—Dallas 1983, no writ) (disclaimer or warranties on computer bar to DTPA claim).

92. 688 S.W.2d 890 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

93. *Id.* at 892-93.

94. *Id.* at 892. The language of this finding tracks the wording of TEX. BUS. & COM. CODE ANN. § 17.46(b)(7) (Vernon Supp. 1986).

95. 688 S.W.2d at 892-93.

96. TEX. BUS. & COM. CODE ANN. § 2.601 (Tex. UCC) (Vernon 1968).

97. *Id.* § 2.602(a).

98. *Id.* § 2.606(a).

99. *Id.* § 2.607(a).

100. 688 S.W.2d 693 (Tex. App.—Amarillo 1985, no writ).

and retained the goods.<sup>101</sup> The court required the buyer to pay the contract price for the goods, less an offset for some goods that were not delivered.<sup>102</sup>

Under the scheme of chapter 2 of the Code, even if a buyer fails to make an effective rejection and becomes liable to pay at the contract rate for goods that are accepted, the buyer may be entitled to recover damages from the seller for a breach of the warranty covering the accepted goods.<sup>103</sup> The right to recover damages for a warranty breach is contingent on the buyer's giving prompt notice of the breach.<sup>104</sup> Failure to give notice within a reasonable time after discovery operates to bar the buyer from any remedy under the Code.<sup>105</sup>

In *Carroll Instrument Co. v. B.W.B. Controls, Inc.*<sup>106</sup> the seller sued the buyer for payment of the contract price. The buyer defended on the alternative grounds that it had never accepted the goods or, if accepted, the goods were defective and it had given proper notice of the breach. The court held that the buyer properly gave notice by showing one of the defective parts to a representative of the seller and that this notice was sufficient to reject the goods when the buyer exercised no further dominion or control over them.<sup>107</sup> The court was thus not required to reach the question of recovery for breach of warranty.

In *Wilcox v. Hillcrest Memorial Park*<sup>108</sup> the buyer's notification was less effective. The buyer gave notice of a defect to the immediate seller of the goods, but failed to notify the remote manufacturer. The court held that the buyer's failure to give notice to the manufacturer barred any recovery against the manufacturer.<sup>109</sup> The court expressly disagreed with an earlier decision<sup>110</sup> by the El Paso court of appeals, which held that notice to the immediate seller was the only notice required to preserve the buyer's breach of warranty action even against a remote manufacturer.<sup>111</sup>

#### D. Remedies and Statute of Limitations

Under section 2.725 of the Code a buyer must bring an action for breach of warranty within four years after the breach occurs.<sup>112</sup> Unless the war-

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101. *Id.* at 696. The buyer of the restaurant and related restaurant inventory took possession of the restaurant, but later tried to reject the inventory delivered because part of the inventory was missing. The court held that acceptance of the restaurant precluded the buyer from rejecting the inventory. *Id.*

102. *Id.* at 696.

103. TEX. BUS. & COM. CODE ANN. § 2.714 (Tex. UCC) (Vernon 1968).

104. *Id.* § 2.607(c).

105. *Id.*

106. 677 S.W.2d 654 (Tex. App.—Houston [1st Dist.] 1985, no writ).

107. *Id.* at 657-59.

108. 696 S.W.2d 423 (Tex. App.—Dallas 1985, no writ).

109. *Id.* at 425.

110. See *Vintage Homes, Inc. v. Coldiron*, 585 S.W.2d 888-89 (Tex. Civ. App.—El Paso 1979, no writ).

111. 696 S.W.2d at 425. The court noted that at least one another Texas case had also required notice to a remote manufacturer, *Melody Homes Mfg. Co. v. Morrison*, 502 S.W.2d 196, 202 (Tex. Civ. App.—Houston [1st Dist.] 1973, writ ref'd n.r.e.) (manufacturer of mobile home notified of defect within a reasonable time after discovery).

112. TEX. BUS. & COM. CODE ANN. § 2.725(a) (Tex. UCC) (Vernon 1968).

ranty explicitly extends to future performance of the goods, a breach occurs when tender of delivery is made.<sup>113</sup> The decision in *Garcia v. Texas Instruments, Inc.* introduced some confusion into Texas law.<sup>114</sup> The Texas Supreme Court failed to note clearly whether it was measuring the four-year time period from the date of tender or from the date of discovery of the defect.<sup>115</sup> The lower appellate courts are correcting this confusion by clearly identifying the date of tender of delivery as the triggering date for measuring the four-year statute of limitations. In five cases decided during the survey period the courts were careful to specify the tender of delivery as the critical event that begins the running of the statute.<sup>116</sup>

An important sidelight to this statute of limitations issue was raised in *Cooper v. Republic Bank Garland*.<sup>117</sup> In this case the buyers had contracted for the installation of a backyard swimming pool. The contractor soon thereafter assigned the contract to a bank. When the buyers discovered defects in the pool they sued the contractor and recovered a judgment that was never satisfied. The buyers ultimately notified the bank that they would no longer make payments under the assigned contract and the bank threatened foreclosure under the contract. The buyers then sued the bank, seeking a permanent injunction against foreclosure and demanding return of all monies previously paid to the bank under the contract. The court held that any claim by the buyers was barred by the four-year statute of limitations of either section 2.725 of the Code<sup>118</sup> or article 5527 of the Civil Statutes<sup>119</sup> as it existed when the cause of action arose.<sup>120</sup> The buyers were, however, entitled to offset the amount of their damages against the remaining balance due under the contract as a defensive matter, even though the statute of limitations had run on their affirmative claim.<sup>121</sup> This defensive use of accrued

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113. *Id.* § 2.725(b).

114. 610 S.W.2d 456, 457 (Tex. 1980).

115. A more extensive discussion of this problem may be found in Krahmer, *supra* note 86, at 221-22.

116. *Cooper v. RepublicBank*, 696 S.W.2d 629, 633 (Tex. App.—Dallas 1985, no writ) (statute of limitations for breach of warranty occurs when tender is made); *Weeks v. J.I. Case Co.*, 694 S.W.2d 634, 635-36 (Tex. App.—Texarkana 1985, no writ) (statute of limitations began to run when farm equipment delivered); *Safeway Stores, Inc. v. Centainteed Corp.*, 687 S.W.2d 22, 24 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (statute of limitations began to run when roofing material delivered); *Fitzgerald v. Caterpillar Tractor Co.*, 683 S.W.2d 162 (Tex. App.—Fort Worth 1985, writ ref'd n.r.e.) (statute of limitations began to run when forklift was delivered to employer).

117. 696 S.W.2d 629 (Tex. App.—Dallas 1985, no writ).

118. TEX. BUS. & COM. CODE ANN. § 2.725(a) (Tex. UCC) (Vernon 1968).

119. *Id.* art. 5527 (Vernon 1979). An issue existed as to whether the pool qualified as a good as defined in *Id.* § 2.105 (Tex. UCC) (Vernon 1968). The court did not have to decide this issue because both § 2.725 and art. 5527 contained a four-year time period and, under either statute, more than four years had passed before the plaintiffs brought action.

120. 696 S.W.2d at 633-34.

121. *Id.* at 634. In support of this result, the court quoted the following passage from the earlier case of *Shaw v. First State Bank*, 13 S.W.2d 133 (Tex. Civ. App.—Fort Worth 1928, no writ): "[l]imitation is applicable to the remedy and not the right. The right, as distinguished from the remedy is often available in equity as a defense, when the remedy for its enforcement would be barred, if asserted affirmatively in a legal action." *Id.* at 137 (citations omitted).

damages by way of offset even after a statute of limitations has run can be a useful tool for an attorney.

### III. COMMERCIAL PAPER

#### A. *Form of Negotiable Instruments*

The most fundamental dichotomy in chapter 3 of the Code<sup>122</sup> is whether an instrument is negotiable or non-negotiable. If an instrument is negotiable, a purchaser may qualify as a holder in due course and gain all of the rights attendant upon such status, including the right to enforce the instrument despite the existence of personal defenses.<sup>123</sup> If an instrument is non-negotiable the purchaser is only an assignee and remains subject to any defenses or claims that a maker or indorser may assert against the instrument.<sup>124</sup> In *Amarillo National Bank v. Dilday*<sup>125</sup> the court was faced with an unusual situation. A certificate of deposit met all of the requirements to qualify as a negotiable instrument,<sup>126</sup> but the certificate was denominated on its face as being non-negotiable. The court concluded that nothing in chapter 3 prohibited the parties to an instrument from agreeing to make the instrument non-negotiable even though it might otherwise meet the formal requirements for negotiability.<sup>127</sup> The issuing bank had urged the court to hold the certificate non-negotiable because it had paid the proceeds of the instrument to one of two joint payees without requiring presentation of the certificate. By destroying negotiability the bank sought to raise the defense of payment against the claim of the other joint payee, who still held the certificate. This defense would have been untenable if the instrument had been negotiable.<sup>128</sup> Although the bank won the battle on negotiability, it still lost the war on the defense of payment, because the certificate specified that the bank was to make payment "on return of this certificate properly endorsed."<sup>129</sup> By failing to require return of the certificate, the bank breached its contractual obligation to the joint depositor who had possession of the instrument and who could have done nothing more to protect her interest in the certificate. The court, therefore, held the bank liable for the full amount of the certificate of deposit.<sup>130</sup>

#### B. *Liability of Parties*

1. *Signatures by Representatives.* Section 3.401 of the Code provides that "[N]o person is liable on an instrument unless his signature appears

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122. TEX. BUS. & COM. CODE ANN. §§ 3.101-.805 (Tex. UCC) (Vernon 1968).

123. See *Id.* § 3.305 (listing rights of a holder in due course).

124. See *Id.* § 3.306 (listing limited rights of a non-holder in due course).

125. 693 S.W.2d 38 (Tex. App.—Amarillo 1985, no writ).

126. See TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon 1968) (listing formal requisites for negotiability).

127. 693 S.W.2d at 41.

128. Payment must be made to the holder of a negotiable instrument to effect a discharge. TEX. BUS. & COM. CODE ANN. § 3.603 (Tex. UCC) (Vernon 1968).

129. 693 S.W.2d at 40 (emphasis omitted).

130. *Id.* at 43.

thereon."<sup>131</sup> This fundamental rule of commercial paper is at the heart of a considerable amount of litigation concerning the liability of parties, whether as principals or agents. In *Anderson v. Badger*<sup>132</sup> the court had little difficulty in finding that an individual was not liable on an instrument that he had neither signed nor ratified as an obligation of his partnership.<sup>133</sup> The court in *Eggers v. Hinckley* reached a different result.<sup>134</sup> The court found that the members of a joint venture had authorized one of the venturers to sign a promissory note on their behalf.<sup>135</sup> Based on this authorization, the members of the venture were held liable on the note.<sup>136</sup>

In three other recent cases the defendants sought to avoid liability on the theory that they had signed the instruments only as representatives and did not intend to become personally obligated.<sup>137</sup> Under the doctrine of *Seale v. Nichols*,<sup>138</sup> the classic Texas case on this issue, a person who signs a promissory note is presumed to be liable in an individual capacity unless he or she can carry the burden of proof to the contrary.<sup>139</sup> If the plaintiff has moved for a summary judgment, this burden includes presentation of sufficient evidence to raise a fact issue on the elements of the affirmative defense of signature made in a representative capacity.<sup>140</sup> In two of the recent cases the person asserting this affirmative defense was unable to survive a motion for summary judgment because of failure to introduce enough evidence to raise an issue of fact that would overcome the presumption of individual liability.<sup>141</sup> In the third case the allegation of representative capacity was unsupported at trial and the presumption of individual liability resulted in a judgment rendered against the alleged agent.<sup>142</sup> The lesson one should learn from these cases is very simple: agents who sign commercial papers for their principals should always disclose on the paper itself that they are signing only in a representative capacity.

2. *Liability for Contribution Between Co-Makers.* Under pre-Code law when one co-maker paid the entire amount of a note he or she was entitled to receive contribution from the other co-makers based on an implied prom-

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131. TEX. BUS. & COM. CODE ANN. § 3.401(a) (Tex. UCC) (Vernon 1968).

132. 693 S.W.2d 645 (Tex. App.—Dallas 1985, no writ).

133. *Id.* at 647.

134. 683 S.W.2d 473 (Tex. App.—Dallas 1985, no writ).

135. *Id.* at 475.

136. *Id.* at 478.

137. *Bryd v. Southwest Multi-Copy, Inc.*, 693 S.W.2d 704 (Tex. App.—Houston [14th Dist.] 1985, no writ); *Retamco, Inc. v. Dixilyn-Field Drilling Co.*, 693 S.W.2d 520 (Tex. App.—Houston [14th Dist.] 1985, no writ); *A. Duda & Sons, Inc. v. Madera*, 687 S.W.2d 83 (Tex. App.—Houston [1st Dist.] 1985, no writ).

138. 505 S.W.2d 251 (Tex. 1974).

139. *Id.* at 254.

140. *Id.*

141. *Bryd v. Southwest Multi-Copy, Inc.*, 693 S.W. 704, 706 (Tex. App.—Houston [14th Dist.] 1985, no writ); *Retamco, Inc. v. Dixilyn-Field Drilling Co.*, 693 S.W.2d 520, 521 (Tex. App.—Houston [14th Dist.] 1985, no writ).

142. *A. Duda & Sons, Inc. v. Madera*, 687 S.W.2d 83, 85 (Tex. App.—Houston [1st Dist.] 1985, no writ).

ise of reimbursement.<sup>143</sup> In *Siegler v. Ginther*<sup>144</sup> the court determined that the Code has not changed the common law rules on contribution and that one co-maker who pays an instrument is still entitled to seek contribution from the other co-makers.<sup>145</sup> The action for contribution is not an action on the instrument, so any defenses that the law makes available to the other co-makers can be raised in the action without regard to issues of holder in due course status.<sup>146</sup> In *Siegler* the co-maker against whom contribution was sought was able to raise successfully a defense based on a special agreement made at the signing of the note.<sup>147</sup> Based on this defense the claim for contribution was denied.<sup>148</sup>

3. *Liability of Holders to Makers.* The Federal Trade Commission holder in due course rule<sup>149</sup> has introduced a new form of liability on instruments that runs from holders to makers. In *Kish v. Van Note*<sup>150</sup> the Texas Supreme Court permitted the makers of a note to recover the amount paid to the holder along with attorney's fees, as well as additional damages against a defaulting contractor.<sup>151</sup> The makers had contracted for the installation of a fiberglass swimming pool. They arranged financing with a bank under a note and contract that contained the required FTC notice.<sup>152</sup> The contractor's attempted installation was a total failure and the pool was never functional. The disappointed makers sued the contractor, the bank, and the insurance company that had insured the bank against default on the loan. The jury found every submitted issue in favor of the makers. The supreme court ruled that, as against the contractor, the makers were entitled to recover under both the Deceptive Trade Practices Act<sup>153</sup> and the Consumer Credit Code,<sup>154</sup> including the recovery of statutory penalties under both statutes.<sup>155</sup> As against the insurer, which had become the holder by assignment from the bank, the makers were entitled to cancellation of the lien created by the note and contract because of the total failure of consideration for the note.<sup>156</sup> The terms of the note also specified that the holder was subject to

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143. See, e.g., *Caldwell v. Stevenson*, 567 S.W.2d 278, 280 (Tex. Civ. App.—Austin 1978, no writ); *Charles v. Charles*, 478 S.W.2d 133, 135 (Tex. Civ. App.—Dallas 1972, writ ref'd n.r.e.); *Bietel v. Bietel*, 109 S.W.2d 345, 348 (Tex. Civ. App.—San Antonio 1937, writ dism'd).

144. 680 S.W.2d 886 (Tex. App.—Houston [1st Dist.] 1984, no writ).

145. *Id.* at 890.

146. *Id.*

147. *Id.*

148. *Id.* at 891.

149. See 16 C.F.R. § 433.1-2 (1985). The rule has been in effect since 1976 and requires that any consumer credit contract or note contain the following notice in at least ten-point bold type: "Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof." 16 C.F.R. § 433.2 (1985).

150. 692 S.W.2d 463 (Tex. 1985).

151. *Id.* at 469.

152. See *supra* note 149 for the required notice.

153. TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon Supp. 1986).

154. *Id.* art. 5069—1.101 to 5069—15.08.

155. 692 S.W.2d at 467.

156. *Id.* at 468.



any claims that could be asserted against the contractor.<sup>157</sup> As against the bank, the makers were entitled to recovery of all amounts paid to the bank under the note and contract.<sup>158</sup> The court also held the insurer and the bank jointly and severally liable for the attorney's fees incurred by the makers in prosecuting an appeal of the case.<sup>159</sup> This case is a clear demonstration that financing lenders should take the FTC rule to heart when a flagrant default occurs on the underlying contract.

### C. Discharge of Parties

1. *Tender of Payment as Partial Discharge.* Most negotiable notes contain provisions for the payment of interest, costs of collection, and attorney's fees. A party can avoid liability for the subsequent accrual of these expenses by making a tender of full payment when or after a note comes due.<sup>160</sup> In *Churchill v. Russey*<sup>161</sup> a junior lienholder tendered full payment of a vendor's lien note to the holder. The holder refused the payment. In a subsequent action the holder asserted the right to recover the amount of the note along with attorney's fees and costs of collection. The court allowed recovery for the amount of the note plus interest to the time of tender, but correctly applied the Code rule on tender of payment and denied recovery of subsequent interest, attorney's fees, and costs.<sup>162</sup>

2. *Discharge by Impairment of Collateral.* Section 3.606 of the Code discharges a party from liability on an instrument whenever the holder unjustifiably impairs collateral given as security for the instrument.<sup>163</sup> A split of authority exists as to whether the co-maker of a note can claim the benefit of this rule.<sup>164</sup> In a significant decision handed down during the survey period, *Crimmins v. Lowry*,<sup>165</sup> the Texas Supreme Court held that a co-maker is a

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157. *Id.*

158. *Id.*

159. *Id.*

160. TEX. BUS. & COM. CODE ANN. § 3.604(a) (Tex. UCC) (Vernon 1968).

161. 692 S.W.2d 596 (Tex. App.—Fort Worth 1985, no writ).

162. *Id.* at 598.

163. TEX. BUS. & COM. CODE ANN. § 3.606(a)(2) (Tex. UCC) (Vernon 1968).

164. Cases holding that co-makers can be discharged include: *Rushton v. U.M.&M Credit Corp.*, 245 Ark. 703, 434 S.W.2d 81, 83-84 (1968) (unjustifiable impairment of collateral may release co-maker; co-maker held liable, however, because collateral not unjustifiably impaired); *Southwest Fla. Prod. Credit Ass'n v. Schirow*, 388 So.2d 338, 339 (Fla. Dist. Ct. App. 1980) (recognizing split of authority; adopting view that co-maker discharged if unjustifiable impairment of collateral); *Beneficial Fin. Co. v. Hasner*, 82 Misc. 2d 550, 369 N.Y.S.2d 975, 978 (1975) (wife sold collateral below fair market value to related party; husband discharged for fair value of collateral if lender knew of husband's right of recourse against wife). Cases holding co-makers are not discharged include: *Wohluter v. St. Charles Lumber & Fuel Co.*, 62 Ill. 2d 16, 338 N.E.2d 179, 182 (1975) (discharge for impairment of collateral does not apply to co-makers); *Smiley v. Wheeler*, 602 P.2d 209, 212 (Okla. 1979) (defense not available to makers who transfer rights in collateral to third party); *Oregon Bank v. Baardson*, 256 Or. 454, 473 P.2d 1015, 1017-18 (1970) (bank's impairment of collateral did not discharge co-maker); *Commerce Union Bank v. May* 503 S.W.2d 112, 116-17 (Tenn. 1973) (holder's failure to maintain fire insurance did not discharge co-maker).

165. 691 S.W.2d 582 (Tex. 1985).

surety to the extent of the co-maker's right of contribution.<sup>166</sup> The co-maker should, therefore, be entitled to assert a discharge if the co-maker's right of recourse has been unjustifiably impaired.<sup>167</sup> This decision places Texas in line with those jurisdictions that extend the benefit of discharges under section 3.606 to the co-makers of secured promissory notes.<sup>168</sup> The defense of discharge because of the unjustifiable impairment of collateral is an affirmative defense which the party asserting the defense must raise,<sup>169</sup> since the defense is waived if not raised by a timely pleading.<sup>170</sup>

#### IV. BANK TRANSACTIONS

##### A. Bank/Customer Relationships

1. *Joint Accounts.* In *Chopin v. Interfirst Bank Dallas*<sup>171</sup> and *Magee v. Westmoreland*<sup>172</sup> the courts considered the issue whether the funds in a joint bank account passed to the surviving joint depositor upon the death of the other depositor or whether the funds became property of the decedent's estate. In both cases the courts concluded that even though parties could effect a nontestamentary transfer of rights in a joint account, the mere establishment of a joint account was not sufficient to infer a survivorship agreement that courts would view as effective under section 439 of the Probate Code.<sup>173</sup> Both courts noted that the terms of the account agreement between the bank and its customer are crucial to a determination of ownership rights.<sup>174</sup> Three elements are required to create an effective survivorship agreement: (1) there must be a written agreement (2) signed by the decedent (3) that makes the interest of the decedent survive to the other party.<sup>175</sup> Extrinsic evidence is not admissible to show the intent of the decedent to create a survivorship interest; the party claiming the interest must show intent by using the written agreement itself.<sup>176</sup> The courts found in both cases that the deposit agreements were not sufficient to create a survivorship interest and the funds in the accounts were thus property of the decedents' estates.<sup>177</sup>

Other problems with joint accounts can occur while the joint depositors are still alive, as demonstrated by *William v. Cullen Center Bank & Trust*.<sup>178</sup> In *Williams* the bank sued both joint depositors to recover the amount of an

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166. *Id.* at 585.

167. *Id.*

168. See *supra* note 164 and cases cited therein.

169. 691 S.W.2d at 585.

170. *Gonzales v. Pan Am. Nat'l Bank*, 692 S.W.2d 111, 111-12 (Tex. App.—Dallas 1985, no writ).

171. 694 S.W.2d 79 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

172. 693 S.W.2d 612 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

173. 694 S.W.2d at 83; 693 S.W.2d at 615-16. See TEX. PROB. CODE ANN. § 439(a) (Vernon 1980).

174. 694 S.W.2d at 83; 693 S.W.2d at 616.

175. 694 S.W.2d at 83; 693 S.W.2d at 616.

176. 694 S.W.2d at 84; 693 S.W.2d at 616.

177. 694 S.W.2d at 85; 693 S.W.2d at 617.

178. 685 S.W.2d 311 (Tex. 1985).

overdraft on their joint checking account. One of the depositors never appeared and a default judgment was rendered against him. The other depositor was able to show that she had never signed a check on the account and had never made a withdrawal from the account. The court noted that community property theories were not applicable to the case because the bank had not presented any evidence that the depositors were husband and wife.<sup>179</sup> The issue posed for decision was, therefore, whether the bank's right to charge the account under section 4.401 of the Code<sup>180</sup> included the right to recover the amount of an overdraft from a joint depositor who had not participated or benefited from the overdraft and who had not ratified the transaction creating the overdraft. After a careful review and analysis of both primary and secondary authorities,<sup>181</sup> the court held that the better view was that the bank could not recover the overdraft from the joint depositor in the absence of proof of participation, benefit, or ratification.<sup>182</sup> The court also suggested that a bank could include express language creating joint liability for overdrafts in a deposit agreement when the account is first established as an alternative means of recovering for overdrafts,<sup>183</sup> but the bank had not done so in this case.

2. *Duty of Bank to Raise Customer's Defenses in Garnishment Proceedings.* In *Southwest Bank & Trust Co. v. Calmark Asset Management, Inc.*<sup>184</sup> a bank was served with a writ of garnishment against its customer's bank accounts. At the time the writ was served the customer had an account denominated as "Calmark Asset Management, Inc. in trust for LaSpanda Apts."<sup>185</sup> The bank notified its customer of the garnishment and advised the customer to obtain counsel. In its answer to the garnishment proceedings, however, the bank stated that it was indebted to "Cal-Mark Asset Management, Inc." The answer did not indicate that the account carried a trust

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179. *Id.* at 312.

180. TEX. BUS. & COM. CODE ANN. § 4.401 (Tex. UCC) (Vernon 1968).

181. Among the authorities reviewed by the court were the cases of: *Popp v. Exchange Bank*, 189 Cal. 296, 208 P. 113, 114 (1922) (making co-signers jointly liable would make every co-signature a partnership); *Bremen Bank & Trust Co. v. Bogdan*, 498 S.W.2d 306, 310 (Mo. Ct. App. 1973) (wife who was signatory on husband's business account held jointly liable; case decided on basis of Missouri statutes and not U.C.C.); *Cambridge Trust Co. v. Carney*, 115 N.H. 94, 333 A.2d 442, 444 (1975) (acknowledging commentators split as to nondrawing co-signer's liability); *United States Trust Co. v. McSweeney*, 91 A.D.2d 7, 457 N.Y.S.2d 276, 279 (1982) (co-tentants are not automatically agents for each other); *National Bank v. Derhammer* (No. 1), 16 Pa. D. & C.2d 286, 288 (1958) (parties clearly identified as husband and wife). Secondary authorities include: B. CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* ¶ 2.8[4] (1981) (arguing banks should expressly make all co-signers liable for the overdrafts of the others); 1 W. HAWKLAND, *A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE* 385-86 (1964) (arguing co-signers should be jointly liable); Note, *Liability for Overdrafts of a Joint Bank Account under the UCC*, 1976 B.Y.U. L. REV. 499, 507-08 (make co-signers jointly liable will encourage banks to pay overdrafts and, therefore, expand commercial practices).

182. 685 S.W.2d at 315.

183. *Id.* at 314.

184. 694 S.W.2d 199 (Tex. App.—Dallas 1985, no writ).

185. *Id.*

designation. A court rendered judgment awarding the garnishor the entire amount in the account and the bank paid the judgment on the next day.

In a subsequent action by the customer against the bank the court held that the bank had a duty to disclose the trust designation of the account in the garnishment proceeding.<sup>186</sup> Failure to fulfill this duty rendered the bank liable to the customer to the extent that the funds were actually trust funds.<sup>187</sup> The court entered judgment in favor of the customer for the full amount of the trust account.<sup>188</sup>

### B. Bank Payments

1. *Items not Properly Payable.* A bank is always entitled to charge items against an account if the items are "properly payable" from that account.<sup>189</sup> If a bank mistakenly pays an item that is not properly payable, the bank may still be able to charge the account by exercising the rights of subrogation provided in section 4.407 of the Code.<sup>190</sup> In *American Communications Telecommunications, Inc. v. Commerce North Bank*<sup>191</sup> a deposit agreement required two signatures on all checks for more than \$500 drawn against a customer's checking account. The bank erroneously paid a check for some \$1800 that bore only one signature. In an action by the customer to recredit the account the bank was able to subrogate itself successfully to the rights of the payee against the customer and avoid liability for the error.<sup>192</sup>

2. *Late Return of Items.* Under section 4.302 of the Code a bank is accountable for the amount of an item presented to it that is not paid or returned by midnight of the banking day following the day of presentment.<sup>193</sup> In *Financial Universal Corp. v. Mercantile National Bank*,<sup>194</sup> a case of first impression in Texas,<sup>195</sup> the Dallas court of appeals held that this rule is applicable to items that are re-presented to a bank a second time following an initial timely dishonor.<sup>196</sup> The payor bank failed to give a timely notice of dishonor after the second presentment. The bank argued that section

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186. *Id.* at 200.

187. *Id.*

188. *Id.* at 201.

189. TEX. BUS. & COM. CODE ANN. § 4.401(a) (Tex. UCC) (Vernon 1968).

190. *Id.* § 4.407. The section provides, *inter alia*, that:

If a payor bank has paid an item . . . under circumstances giving a basis for objection by the drawer or marker. . . . the payor bank shall be subrogated to the rights

(1) of any holder in due course on the item against the drawer or maker; and  
(2) of the payee or any other holder of the items against the drawer or maker either on the item or under the transaction out of which the item arose; and  
(3) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

*Id.*

191. 691 S.W.2d 44 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.).

192. *Id.* at 47-48.

193. TEX. BUS. & COM. CODE ANN. § 4.302 (Tex. UCC) (Vernon 1968).

194. 683 S.W.2d 815 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

195. *Id.* at 817.

196. *Id.* at 817-18.

4.302 only applied to the original presentment of an item. The court rejected this argument.<sup>197</sup> The bank also argued that the presenting bank had represented the check as a collection item instead of a demand item because of a notice that accompanied the check when it was presented the second time. Although the court did not believe the notice accompanying the check was itself sufficient to demonstrate that the check was a collection item, the summary judgment evidence did not conclusively negate the possibility that an agreement or custom existed between the presenting bank and the payor bank that would excuse the payor from compliance with the rule of section 4.302.<sup>198</sup> The court remanded the case for trial on that issue.<sup>199</sup>

3. *Process of Posting Abolished as a Means of Final Payment.* As a result of 1985 legislative action<sup>200</sup> the process of posting is no longer an indicator of whether an item has been finally paid.<sup>201</sup> Under the revised version of section 4.213 an item is now treated as finally paid when the payor bank has done any one of the following:

- (1) paid the item in cash; or (2) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or (3) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.<sup>202</sup>

The legislature also added a provision permitting banks to accept, pay, or charge an item to an account before or after regular banking hours.<sup>203</sup> Under the revision a bank is not obligated to determine the time of day an item is received. The bank may also withhold the amount of an item, without liability, pending a determination of the priority of the item vis-a-vis competing claims, stop-orders, or legal process served on the bank.<sup>204</sup> One practical effect of these changes is to delay the moment of final payment to the midnight deadline, except for items that are paid in cash, a result that closely parallels that of *West Side Bank v. Marine National Exchange Bank*.<sup>205</sup> A second effect is to insulate the bank from liability when a question of the priority of payment of an item arises.<sup>206</sup>

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197. *Id.* at 816-18.

198. *Id.* at 818-19. An agreement or custom between banks can extend the time allowed for payment or dishonor beyond the midnight deadline. See TEX. BUS. & COM. CODE ANN. § 4.103 (Tex. UCC) (Vernon 1968).

199. 683 S.W.2d at 819.

200. Act of June 14, 1985, ch. 621, 1985 Tex. Gen. Laws 4721.

201. See TEX. BUS. & COM. CODE ANN. § 4.213(a) (Tex. UCC) (Vernon Supp. 1986).

202. *Id.*

203. See *Id.* § 4.303(b).

204. *Id.*

205. 37 Wis. 2d 661, 155 N.W.2d 587, 593-95 (1968) (allowing reversals of entries for any reason if within time allowed for return of items to clearinghouse).

206. For some of the difficulties encountered by a bank under the process of posting rule, see *Consolidated Cigar Co. v. Texas Commerce Bank*, 749 F.2d 1169, 1171-73 (5th Cir. 1985) (mechanical processing and later discretionary review complicate determination of final posting).

## V. LETTERS OF CREDIT

## A. Definitions and Procedure

1. *Standby Credit or Documentary Credit?* In *Apex Oil Co. v. Archem Co.*<sup>207</sup> a contract for the sale of propane called for the buyer to provide a standby letter of credit as security for payment of the purchase price. The first line of the letter of credit that the buyer provided stated, "this is a documentary credit and not a stand by credit."<sup>208</sup> The seller refused to perform under the contract on the ground that the buyer had breached its obligation to provide a standby credit. The buyer sued and the court granted a summary judgment in its favor. The seller appealed. This case provided the court with an opportunity to write a brief dictionary of meanings for a series of letter of credit terms that have come into common legal use in the last few years, but are not terms of art defined in the Code itself.<sup>209</sup> The court's definitions are helpful and are included here as a reference for attorneys involved in letter of credit transactions.

The court defined a standby letter of credit as one " 'whereby the issuer agrees to pay the beneficiary upon presentment of documentation indicating that the account party has defaulted on a payment obligation . . . [and] is used primarily to finance or secure an underlying intangible or money indebtedness undertaken by the account party.' " <sup>210</sup> A "documentary" letter of credit is one that requires "a 'draft on the letter of credit [to] be accompanied by some document, such as a document of title or a certificate of default.' " <sup>211</sup> The court contrasted the documentary letter with a clean letter of credit, "which 'is payable merely upon the presentation of a draft [with] no accompanying documents.' " <sup>212</sup> The *Apex Oil* court held that the terms documentary credit and standby credit are not mutually exclusive and that the buyer had fulfilled its obligation under the contract of sale.<sup>213</sup>

2. *Letter of Credit Disputes as Basis for Interpleader.* Interpleader is a procedural device designed to protect an innocent stakeholder from multiple litigation and the risk of multiple liability.<sup>214</sup> In *Dallas Bank & Trust Co. v. Commonwealth Development Corp.*<sup>215</sup> a bank that had issued a standby letter of credit to a beneficiary on behalf of two of its customers sought to interplead the beneficiary and the customers to avoid what it viewed as possible multiple liability. The court's analysis of section 5.114 of the Code<sup>216</sup> led to

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207. 770 F.2d 1353 (5th Cir. 1985).

208. *Id.* at 1354.

209. TEX. BUS. & COM. CODE ANN. §§ 5.1101-.117 (Tex. UCC) (Vernon 1968 & Supp. 1986) govern letter of credit transactions.

210. 770 F.2d at 1355 (quoting *Republic Nat'l Bank v. Northwest Nat'l Bank*, 578 S.W.2d 109, 113 (Tex. 1979)).

211. 770 F.2d at 1355 (quoting *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 601 (5th Cir. 1979)).

212. *Id.*

213. 770 F.2d at 1356.

214. 1 R. McDONALD, TEXAS CIVIL PRACTICE § 3.38 (1981).

215. 686 S.W.2d 226 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

216. TEX. BUS. & COM. CODE ANN. § 5.114 (Tex. UCC) (Vernon 1968 & Supp. 1986).

the conclusion that interpleader was not a procedure available to the bank.<sup>217</sup> Since the bank was entitled either to honor or dishonor the demand for payment under the letter of credit, the bank would not be liable to its customers for whichever decision it made.<sup>218</sup> The risk that payment under the credit might leave the bank without a right to reimbursement against the customers was not regarded as "the kind of exposure to multiple liability that would justify interpleader relief."<sup>219</sup> Even though the court deemed interpleader improper, since all parties were before the court, it exercised discretion and treated the case as one of permissive joinder of a request for declaratory relief for purposes of the appeal.<sup>220</sup> By virtue of the pleadings that the parties had filed in the case, the court held that the beneficiary was entitled to the fund as the only party asserting an interest in the fund.<sup>221</sup> The court also held that judicial admissions contained in the bank's pleadings established that neither customer was liable to reimburse the bank for moneys paid out under the letter of credit.<sup>222</sup> This case seems to demonstrate that, for a bank, interpleading a letter of credit can be a little bit like leaving the vault unlocked.

### B. *Payment Under a Letter of Credit*

In *Westwind Exploration, Inc. v. Homestead Savings Association*<sup>223</sup> the Texas Supreme Court reaffirmed the rule that a beneficiary is required strictly to comply with the terms of a letter of credit before the issuer must honor a draft drawn under the credit.<sup>224</sup> The court further held that whether the presenting bank has met the standard of strict compliance is a question of law for the court unless an ambiguity exists or if another theory raises an issue concerning the intent of the parties.<sup>225</sup> The letter of credit in question provided that upon presentment, the beneficiary should submit copies of invoices evidencing deliveries of crude oil made during the month of August, 1982. Although the credit was originally to expire in September of 1982, the parties extended the expiration date to December of that year and expressly provided that "[a]ll other terms and conditions shall remain the same."<sup>226</sup> The beneficiary (Westwind) made a demand for payment under the credit for deliveries of oil that had taken place in July, August, September and October. Westwind submitted invoices for deliveries made during these months along with the demand for payment. The supreme court determined that dishonor of the demand was proper because Westwind had not strictly complied with the terms of the credit when it attempted to collect

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217. 686 S.W.2d at 230-31.

218. *Id.*

219. *Id.* at 231.

220. See TEX. R. CIV. P. 43 and TEX. REV. CIV. STAT. ANN. art. 2524-1 (Vernon 1965 & Supp. 1984), upon which the court relied as the basis for its action.

221. 686 S.W.2d at 232.

222. *Id.* at 235.

223. 696 S.W.2d 378 (Tex. 1985).

224. *Id.* at 381.

225. *Id.*

226. *Id.* at 380.

under the credit for oil deliveries made in months other than August.<sup>227</sup> Westwind had raised no theory showing an intent on the part of the issuing bank to extend the bank's liability under the credit to cover oil deliveries made in any month other than August.<sup>228</sup>

## VI. BULK TRANSFERS

*What Constitutes a "Major Part" of the Assets of an Enterprise?* Reported Texas decisions have never interpreted many of the provisions of chapter 6 of the Code.<sup>229</sup> One of the more fundamental issues that has remained open is the question of what constitutes a transfer of a major part of the assets of a business subject to chapter 6.<sup>230</sup> In *Bergen, Johnson & Olson v. Verco Manufacturing Co.*<sup>231</sup> the El Paso court of appeals addressed this issue and concluded that a sale of less than fifteen percent of the inventory of a business did not constitute the sale of a major part of the inventory so as to bring the transaction within the purview of chapter 6.<sup>232</sup>

*Rights of Judgment Creditors in a Bulk Transfer.* In *Rome Industries, Inc. v. Intsel Southwest*,<sup>233</sup> another case of first impression under chapter 6, a judgment creditor contended that it had rights superior to those of other creditors of the transferor by virtue of having obtained a judgment against the transferor before the bulk transfer occurred. The court held that merely obtaining a judgment was not sufficient to perfect a judgment lien against the property of the transferor, and the judgment creditor was only entitled to share in the consideration paid by the transferee on a pro rata basis along with other creditors who had not reduced their claims to judgment.<sup>234</sup> The court also held that service of a writ of garnishment by the judgment creditor on the transferee after the judgment creditor had received notice of the pending bulk transfer would not operate to cut off the rights of other creditors because the proceeds of sale were payable to the creditors of the transferor and not to the transferor itself.<sup>235</sup>

*What Constitutes Concealment of a Bulk Transfer?* In a third novel case under chapter 6<sup>236</sup> the San Antonio court of appeals considered the question of when the parties to a bulk transfer had so concealed the transfer that an

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227. *Id.* at 382.

228. *Id.* at 382.

229. TEX. BUS. & COM. CODE ANN. §§ 6.101-.111 (Tex. UCC) (Vernon 1968) governs the area of bulk transfers. Most of its provisions have never been litigated in Texas.

230. As stated in *Id.* § 6.102(a) a bulk transfer is "any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the material, supplied, merchandise or other inventory (Section 9.109) of an enterprise subject to this chapter." *Id.*

231. 690 S.W.2d 115 (Tex. App.—El Paso 1985, writ ref'd n.r.e.).

232. *Id.* at 118-19.

233. 683 S.W.2d 777 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.).

234. *Id.* at 780-81.

235. *Id.* at 780. In reaching this conclusion the court relied upon TEX. BUS. & COM. CODE ANN. § 6.106 (Tex. UCC) (Vernon 1968).

236. SVM Inc. v. Mexican Exporters, Inc., 685 S.W.2d 424 (Tex. App.—San Antonio 1985, no writ).



aggrieved creditor could bring an action challenging the transfer outside the usual six-month limitations period stated in section 6.111.<sup>237</sup> Although no written notice of the transfer was ever given to creditors, the record disclosed that the aggrieved creditor knew or should have known of the transfer through the conduct of its agents. The aggrieved creditor also had presented no evidence of any affirmative attempt to conceal the transfer. The court held that the concealment "contemplated by section 6.111 occurs when the record discloses affirmative efforts at concealing the transfer and when there had been complete and total failure to comply with the notice provisions of the statute."<sup>238</sup>

*Transfers in Settlement of a Security Interest.* Under section 6.103 of the Code transfers made "in settlement or realization of a lien or other security interests" are exempted from the provisions of chapter 6.<sup>239</sup> In *Hixon v. Pride of Texas Distributing Co.*<sup>240</sup> a debtor paid over all of the proceeds of a bulk transfer to two secured creditors who held perfected security interests in the property of the transferor. The transferee failed to give written notice of the transfer in a timely fashion to the unsecured creditors.<sup>241</sup> One of the unsecured creditors sued for failure to give timely notice. The transferee defended on the ground that this transfer was an exempt transaction under section 6.103 because he paid the proceeds to holders of valid security interests. The court found no Texas cases on point and only a few cases from other jurisdictions.<sup>242</sup> After a review of these authorities the court held that the proper interpretation of section 6.103 was that the exemption for transfers in settlement of a security interest was only applicable if the debtor had defaulted on the secured claims and the secured creditors had a right to foreclose at the time the bulk transfer occurred.<sup>243</sup> Since the secured creditors had presented no evidence of default under either security interest, the court disallowed the claim of exemption and held the transferee liable for failure to give timely notice of the transfer.<sup>244</sup>

## VII. SHIPMENT CONTRACTS

*Carrier's Duties in C.O.D. Shipments.* In a pair of interesting cases, *Duder-*

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237. See TEX. BUS. & COM. CODE ANN § 6.111 (Tex. UCC) (Vernon 1968) (six-month limitation applies unless "the transfer has been concealed").

238. 685 S.W.2d at 430.

239. TEX. BUS. & COM. CODE ANN. § 6.103(3) (Tex. UCC) (Vernon 1968).

240. 683 S.W.2d 173 (Tex. App.—Fort Worth 1985, no writ).

241. TEX. BUS. & COM. CODE ANN. § 6.105 (Tex. UCC) (Vernon 1968) requires notice of a proposed transfer to be given at least ten days before the transferor takes possession of the property.

242. The cases from other jurisdictions were: *Techsonic Indus. v. Barney's Bassin' Shop*, 621 S.W.2d 332, 334 (Mo. Ct. App. 1981) (bulk transfer valid because of evidence of default); *Starman v. John Wolfe, Inc.*, 490 S.W.2d 377, 382-83 (Mo. Ct. App. 1973) (bulk transfer not exempt under § 6.103); *American Metal Finishers, Inc. v. Palleschi*, 55 A.D.2d 499, 391 N.Y.S.2d 170, 172 (1977) (bulk transfers for settlement of indebtedness valid).

243. 683 S.W.2d at 178.

244. *Id.*

*stadt Surveyors Supply, Inc. v. Alama Express, Inc.*<sup>245</sup> and *Swest, Inc. v. American Airlines, Inc.*,<sup>246</sup> the San Antonio court of appeals and the Dallas court of appeals have split on the scope of a carrier's duty in receiving payment under a C.O.D. shipment contract. In *Duderstadt* a motor carrier delivered goods in exchange for a cashier's check that the tenderor had forged. The San Antonio court of appeals reviewed the terms of the shipment contract, as well as the applicable National Motor Freight Classification rules.<sup>247</sup> The court held that the carrier had exercised reasonable care in accepting the cashier's check as C.O.D. payment since the cashier's check was regular on its face and no circumstances made the transaction appear suspicious.<sup>248</sup>

In *Swest* an airline delivered goods under a C.O.D. shipment contract in exchange for a check that appeared certified, but was actually forged. In contrast to the decision in *Duderstadt* the Dallas court of appeals made no reference to any applicable tariff rules or regulations and decided the case solely on the basis of a common law analysis of the carrier's duty of care. Relying largely on a 1928 decision<sup>249</sup> by then Chief Judge Cardozo, the court reasoned that a carrier has a duty to verify the validity of a certified check.<sup>250</sup> Since the airline had taken no steps to verify the certification, it was liable to the shipper for the value of the misdelivered goods.<sup>251</sup> The supreme court has granted a writ in *Swest* and it will be interesting to see how the court deals with this issue.<sup>252</sup>

## VIII. SECURED TRANSACTIONS

### A. *Validity of Security Agreements*

If the author of this article had been asked to select one case as the most significant decision handed down during the survey period the answer would unhesitatingly have been *Gonzalez v. Gainan's Chevrolet City, Inc.*<sup>253</sup> In *Gonzalez* the Texas Supreme Court held "there is no reason to presume the legality of terms and provisions of a contract which are required or prohibited by the Consumer Credit Code and which are not relevant to a finding of usury."<sup>254</sup> With this single statement the supreme court eliminated the doctrine of "presumed legality" that the courts of appeal had developed in numerous cases of alleged Consumer Credit Code violations.<sup>255</sup> The court

245. 686 S.W.2d 351 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

246. 694 S.W.2d 399 (Tex. App.—Dallas 1985, writ granted).

247. Nat'l Motor Freight Classifications 100-H.

248. 686 S.W.2d at 355.

249. *Joseph Mogul, Inc. v. C. Lewis Lavine, Inc.*, 247 N.Y. 20, 159 N.E. 708, 709-10 (1928).

250. 694 S.W.2d at 402.

251. *Id.* at 401-02.

252. The last Texas case to deal with a similar problem appears to have been *Herrin Transp. Co. v. Robert E. Olson Co.*, 325 S.W.2d 826, 828 (Tex. Civ. App.—San Antonio 1959, no writ).

253. 690 S.W.2d 885 (Tex. 1985).

254. *Id.* at 887.

255. Cases applying the doctrine of presumed legality that were specifically overturned by

based the rationale for this decision on the declaration of legislative intent in section 1 of the Consumer Credit Code.<sup>256</sup> In a bow toward precedent the court recognized its earlier decisions in the area of usury that held "a contract which is alleged to be usurious on the ground that it calls for the collection of unearned interest is to be construed as complying with the law, if it is reasonably susceptible of such an interpretation."<sup>257</sup> The court left no doubt, however, that it was limiting the doctrine of presumptive legality to the area of usury and that this doctrine would no longer have any validity in cases involving other alleged violations of the Consumer Credit Code.<sup>258</sup> A dissenting opinion in *Gonzalez* pointed out that a distinction between usury violations and other Credit Code violations "is illusory at best"<sup>259</sup> and "results in an insupportable contradiction."<sup>260</sup> The dissent argued that the courts should apply the doctrine of presumptive legality to any interpretation of the Consumer Credit Code, regardless of the particular violation alleged.<sup>261</sup>

The practical effects of *Gonzalez* are immense. Practitioners should review every security agreement used in consumer credit transactions for literal compliance with the Consumer Credit Code to eliminate any ambiguity that might result in a violation. The possibility always exists, however, that a court might hold one or more clauses that appear innocuous violative of an obscure provision of the Credit Code.<sup>262</sup> One hint of a way to obtain some general protection against this possibility is found in *Jim Walter Homes, Inc. v. Schuenemann*,<sup>263</sup> a usury case cited by the supreme court in its acknowledgment of usury precedents.<sup>264</sup> In *Jim Walter Homes* the court commented:

we fail to understand why acceleration clauses are drafted which do not include a sentence expressly disavowing any intention to collect excessive unearned interest or finance charges in the event the obligation is accelerated. . . . To settle the matter clearly in the contract between the parties is a service to the creditor, the debtor, and the taxpayers of this state."<sup>265</sup>

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the supreme court included *Haley v. Pagan Lewis Motors, Inc.*, 647 S.W.2d 319, 320 (Tex. App.—Corpus Christi 1982, writ ref'd n.r.e.) and *Grant v. Friendly Chrysler-Plymouth, Inc.*, 612 S.W.2d 667, 669 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.). The part of *Hinojosa v. Castellon Chevrolet Oldsmobile, Inc.*, 678 S.W.2d 707 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.) that relied on the doctrine of presumed legality was disapproved.

256. Act of May 23, 1967, Ch. 274, § 1 1967 Tex. Gen. Laws 608; 15 Tex. Rev. Civ. Stat. Ann. pp. 1-2 (Vernon 1971).

257. 690 S.W.2d at 887 (quoting *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d 324, 332 (Tex. 1984)).

258. 690 S.W.2d at 887.

259. *Id.* at 890 (McGee, J., dissenting).

260. *Id.*

261. *Id.*

262. The Consumer Credit Code, TEX. BUS. & COM. CODE ANN. art. 5069—1.01 to—15.08 (Vernon 1971 & Supp. 1986), has been amended at numerous times and has by accretion become cumbersome and uncoordinated. A serious effort to rewrite the entire Credit Code to make it comprehensible is sorely needed.

263. 668 S.W.2d 324 (Tex. 1984).

264. *Gonzalez*, 690 S.W.2d at 887.

265. 668 S.W.2d at 333 n.6.

Borrowing from this suggested drafting technique a creditor might find some protection in a clause that says, in effect: "The parties intended that this contract is to be construed as being in compliance with the Texas Consumer Credit Code and that any ambiguities are to be resolved in favor of the legality of this contract." As extra protection the clause might further provide that "The creditor expressly disavows any intention to violate any of the terms of the Texas Consumer Credit Code and this contract will be enforced only in a manner that is in accordance with the applicable laws of the State of Texas." The parties should also consider the use of bold print and a separate signing in an attempt to make this kind of blanket clause effective. Needless to say, after *Gonzalez* the creditor should follow the chapter and verse of Texas law in any enforcement of a contract.

### B. Priorities

1. *Priorities Between a Lien Creditor and a Secured Party.* One of the most important aspects of a security interest is the protection afforded to a secured creditor against the competing claims of third parties.<sup>266</sup> Such third parties can include lien creditors,<sup>267</sup> trustees in bankruptcy,<sup>268</sup> buyers of goods,<sup>269</sup> or other secured creditors.<sup>270</sup> In *Owen v. Vibrosearch Exploration, Inc.*<sup>271</sup> the court applied section 9.301 of the Code<sup>272</sup> to find that a creditor who acquired a perfected security interest in the accounts receivable of a debtor had priority over the competing claim of a judgment creditor who sought to garnish one of the accounts.<sup>273</sup>

2. *Priorities in Returned Goods.* In a well-reasoned decision<sup>274</sup> the Amarillo court of appeals confronted the issue of the priority of competing secured claims in returned goods. The facts giving rise to the priority dispute can be quickly summarized as follows. Manufacturer sold tractors to Implement Dealer on a secured credit basis under a properly perfected inventory financing agreement. Dealer sold two tractors to Buyer under a purchase money security agreement. The purchase money security agreement constituted chattel paper under the definitional scheme of chapter 9.<sup>275</sup> Dealer sold the chattel paper to Finance Company, which purchased the paper in good faith and in the ordinary course of its business. Buyers later returned the tractors to Dealer. Manufacturer and Finance Company both asserted claims to the tractors.

On these facts the court reasoned that Finance Company had priority in

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266. TEX. BUS. & COM. CODE ANN. § 9.301(a) (Tex. UCC) (Vernon 1968).

267. *Id.* § 9.301(c).

268. *Id.*

269. *Id.* § 9.307 (Vernon Supp. 1986).

270. *Id.* § 9.312.

271. 694 S.W.2d 421 (Tex. App.—Houston [14th Dist.] 1985, no writ.)

272. TEX. BUS. & COM. CODE ANN. § 9.301 (Tex. UCC) (Vernon Supp. 1986).

273. 694 S.W.2d at 425.

274. *Borg-Warner Acceptance Corp. v. C.I.T. Corp.*, 679 S.W.2d 140 (Tex. App.—Amarillo 1984, no writ).

275. TEX. BUS. & COM. CODE ANN. § 9.104(a)(2) (Tex. UCC) (Vernon Supp. 1986).

the chattel paper<sup>276</sup> under the terms of section 9.308 of the Code.<sup>277</sup> The court then applied section 9.306<sup>278</sup> because the buyer had returned the goods to the seller. The court ruled that the Finance Company's priority in the chattel paper continued in the returned goods as against the inventory security interest of the Manufacturer that reattached to the goods upon their return.<sup>279</sup>

3. *Priorities in Negotiable Instruments.* In *Dallas Bank & Trust Co. v. Frigiking, Inc.*<sup>280</sup> two secured creditors each held perfected security interests in inventory. The debtor issued checks to one of the secured parties from proceeds generated by the sale of inventory. The other secured creditor sued to recover the funds represented by these checks. The court held that the secured party receiving these checks met all of the requirements needed to take the checks as a holder in due course.<sup>281</sup> The court also held that under section 9.039 of the Code<sup>282</sup> the holder in due course of a negotiable instrument has priority over a claim based on a perfected security interest.<sup>283</sup>

4. *Priorities in Consigned Goods.* One who delivers goods to another for sale on a consignment basis runs a substantial risk that a creditor of the seller will succeed in asserting a priority claim to the consigned goods.<sup>284</sup> The consignor can obtain protection against this risk by complying with the provisions of sections 9.114 and 9.408 of the Code.<sup>285</sup> Section 9.114 provides for giving notice of the consignment to creditors of the seller.<sup>286</sup> Section 9.408 permits the filing of a special consignment financing statement identifying the interest of the consignor in the consigned goods that are in the seller's possession.<sup>287</sup> Failure to comply with these provisions can result in an expensive mistake, as the consignor discovered in *Marrs v. South Texas National Bank*.<sup>288</sup> In *Marrs* a secured creditor with a perfected security interest in the inventory of a seller was held to have a priority claim to fourteen cars consigned to the seller because of the failure of the consignor to take the protective steps of notification and filing.<sup>289</sup>

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276. 679 S.W.2d at 142.

277. TEX. BUS. & COM. CODE ANN. § 9.308 (Tex. UCC) (Vernon Supp. 1986) (rights of purchasers of chattel paper and non-negotiable instruments).

278. *Id.* § 9.306(e)(1) & (e)(2) (Tex. UCC) (Vernon Supp. 1986) (establishing priorities between seller and secured party is returned or repossessed goods).

279. 679 S.W.2d at 142-143.

280. 692 S.W.2d 163 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

281. *Id.* at 166. *See also* TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon 1968) (requirements for holder in due course status).

282. TEX. BUS. & COM. CODE ANN. § 9.309 (Tex. UCC) (Vernon Supp. 1986) (protection of purchasers of instruments and documents).

283. 692 S.W.2d at 167.

284. *See* TEX. BUS. & COM. CODE ANN. § 2.326(c) (Tex. UCC) (Vernon 1968) (goods of consigner subject to claims of creditors of consignee).

285. *Id.* §§ 9.114 & .408 (Tex. UCC) (Vernon Supp. 1986).

286. *Id.* § 9.114.

287. TEX. BUS. & COM. CODE ANN. § 9.408 (Tex. UCC) (Vernon Supp. 1986).

288. 686 S.W.2d 675 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

289. *Id.* at 678-80.

5. *Priorities in Farm Products.* Persons who buy goods in the ordinary course of business generally take free of security interests that their sellers created.<sup>290</sup> An important exception to this rule denies such protection to a person who buys farm products from a person engaged in farming operations.<sup>291</sup> This exception sometimes allows a secured creditor with a perfected security interest in farm products to maintain successfully an action for conversion against persons who buy the farm products without obtaining a release of the security interests.<sup>292</sup> The 1985 Legislature limited the right of a secured party to assert such conversion claims by adding subsection (d) to section 9.307.<sup>293</sup> Under the amendment a secured party may not enforce a security interest in farm products unless the secured party notifies the buyer within ninety days after the purchase that a security interest exists in the farm products.<sup>294</sup> The notice must state the terms of the security interest and the amount the secured party claims is owed.<sup>295</sup> Although in the author's opinion eliminating or limiting the farm products exception is desirable on a policy level, the amendment in its current form may create more problems than it solves because of a lack of clarity in the wording that will invite litigation by affected secured parties.<sup>296</sup> In the author's view the legis-

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290. TEX. BUS. & COM. CODE ANN. § 9.307(a) (Tex. UCC) (Vernon Supp. 1986).

291. *Id.*

292. See, e.g., *Weisbart & Co. v. First Nat'l Bank*, 568 F.2d 391, 394 n.3 (5th Cir. 1978) (cattle are farm products under § 9.307(a), and therefore, buyer does not take free of security interest created by seller); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99, 103 (1971) (purchaser of cattle held liable for conversion because he did not obtain release); *Cox v. Bancoklahoma Agri-service Corp.*, 641 S.W.2d 400, 402-03 (Tex. App.—Amarillo 1982, no writ) (purchaser of cattle did not obtain release of security agreement; held liable for conversion).

293. TEX. BUS. & COM. CODE ANN. § 9.307(d) (Tex. UCC) (Vernon Supp. 1986). The subsection provides:

(d) A secured party, including a secured party under a security interest covered by Section 9.312(b) of this code, may not enforce a security interest in farm products against a person who has purchased the farm products from a person engaged in farming operations unless the secured party gives notices of the security interest to the buyer by certified mail, return receipt requested, no later than the 90th day after the date of purchase. The notice must state the terms of the security interest and the amount claimed to be owed to the secured party.

*Id.*

294. *Id.*

295. *Id.*

296. For example, the 90-day time period for giving notification begins to run from the date of purchase. When is the date of a purchase? Is it the date when a contract is signed to buy a crop, whether or not the crop has yet been planted? Is it the date when the purchaser acquires an insurable interest in the goods? Is it the date of passage of title or, perhaps, the date of physical delivery to the purchaser? All of these are possible dates of purchase under Chapter 2. See *id.* §§ 2.105 (allowing for present sale of future goods), 2.401 (specifying when title passes), 2.501 (specifying when buyer obtains insurable interest), 2.509 (specifying when risk of loss passes to buyers) (Tex. UCC) (Vernon 1968).

The amendment uses the term "purchase" as if it were interchangeable with the term "buy." They do not have the same meanings under the Code. Any person who acquires an interest in property as part of a voluntary transaction is a purchaser under the Code. Thus, a junior secured party could claim to have purchased farm products and be entitled to notice of the senior security interest even though that interest would otherwise have priority under other provisions of the Code. Under this reading a senior interest would be cut off if notice were not given. See *id.* §§ 1.201(9) (defining "buyer in ordinary course of business"), 1.201(32) (defin-

lature should reconsider the amendment in the 1987 legislative session and, if it still deems a limitation on the farm products exception desirable, it should redraft the amendment in a better form.

Another development in the area of agricultural lending occurred at the federal level after the end of the Survey period by Congressional passage of the "The Food Security Act of 1985."<sup>297</sup> Under this act, a buyer of farm products will take free of a security interest created by the seller unless the secured party gives notification of the security interest to the buyer within one year prior to the sale.<sup>298</sup> The requirement of pre-sale notification introduces an interesting complexity into agricultural lending because a potential buyer must be identified *before* a sale takes place. The act attempts to deal with this problem by permitting secured parties to require the debtor to provide a list of potential buyers so notice of the security interest can be given before a sale occurs.<sup>299</sup> Criminal sanctions can be invoked if the debtor fails to provide the name of the buyer prior to sale.<sup>300</sup> The effective date of the notification provisions is December 23, 1986 so crops produced during the 1986 growing season will generally be unaffected, but secured creditors should begin now to revise security agreements and to develop a system for the giving of notices to avoid the inadvertent loss of a security interest by failure to comply with the federal enactment.

### C. Proceedings After Default

1. *Was There a Default?* Obviously no proceedings after default can occur before a debtor has defaulted. In *Rayos v. Chrysler Credit Corp.*<sup>301</sup> the court determined that no default occurred when the debtor voluntarily requested the cancellation of an extended service plan on a car and sent the refund check to the secured party.<sup>302</sup> The debtor intended that the secured party should apply the refund check to the next two installments due under the security agreement. These installments would have constituted payments three and four, respectively, under the forty-eight month installment contract. Instead of so applying the proceeds of the refund check, the secured party credited the amount toward payment of the last two monthly payments under the 48 month installment contract (i.e., payments forty-seven

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ing "purchase"), 1.201(33) (defining "purchaser"), 2.103(a) (defining "buyer") (Tex. UCC) (Vernon Supp. 1986).

297. H.R. 2100 (passed December 17, 1985, signed December 23, 1985). See Congressional Record for December 17, 1985 at H 12304—12305. An alternative to the giving of notice is provided in the act by permitting a State to establish a central filing system for farm products and obtain certification of the system by the United States Department of Agriculture. The Office of the Texas Secretary of State has no current plans to develop and implement such a central filing system, in part because of the estimated cost of three million dollars at a time when Texas faces severe budgetary constraints.

298. H.R. 2100, § 1324(d) & (e).

299. H.R. 2100, § 1324(h).

300. H.R. 2100, § 1324(h)(3).

The amendment is very specific in how notice must be given. Does this mean that actual notice given in some way other than that specified is not adequate notice?

301. 683 S.W.2d 546 (Tex. App.—El Paso 1985, no writ).

302. *Id.* at 548.

and forty-eight instead of payments three and four, which the debtor had intended to pay). Since the creditor's books reflected payments three and four as unpaid, the creditor declared a default and repossessed the car. The creditor defended on the ground that the security agreement permitted it to apply insurance premium refunds in inverse order of maturity. The court had little difficulty in deciding that a service maintenance contract was more like a warranty plan than an insurance policy and held that no default had taken place.<sup>303</sup> The court remanded for trial the buyer's conversion action for wrongful repossession.<sup>304</sup>

2. *Disposition of Collateral.* After a secured party has come into possession of collateral following default, the two methods of disposition available to the secured party are to retain the collateral in satisfaction of the debt or to resell the collateral in a commercially reasonable manner and sue for any deficiency that may result.<sup>305</sup> According to the court in *Burton v. National Bank of Commerce*<sup>306</sup> the secured party's representations to the debtor about which of these two methods it will use to dispose of collateral can bind the secured party and prevent a later decision to change the method of disposition.<sup>307</sup> In *Burton* the jury findings supported a conclusion that the secured party had waived its right to sell the collateral by an oral representation that the voluntary return of collateral would extinguish the debt as an accord and satisfaction. The court held that the creditor had elected its remedy by its representations and could not change its mind after the debtor voluntarily delivered the collateral to the creditor.<sup>308</sup>

In *Piney Point Investment Corp. v. Photo Design, Inc.*<sup>309</sup> the court held that a creditor had not elected to retain collateral in satisfaction of a debt even though the creditor still had most of the collateral in his possession some two years after repossession.<sup>310</sup> The creditor had sold two items of collateral and had given notice that he would sell the collateral at private sale after a specified date. The sale of these items, however, did not occur until at least six months after the notice. In reaching a decision that the creditor had not elected to retain the collateral the court distinguished *Tanenbaum v. Economics Laboratory, Inc.*<sup>311</sup> *Tanenbaum* sought to prevent double recovery by a creditor who might retain the collateral and still seek a deficiency judgment without having given notice of sale or notice of intention to retain the collateral.<sup>312</sup> In *Piney Point* the creditor had given notice of intent to sell the collateral; the creditor in *Tanenbaum* had given no such

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303. *Id.*

304. *Id.*

305. See TEX. BUS. & COM. CODE ANN. §§ 9.504 (resale of collateral and suit for deficiency), 9.505 (retention of collateral in satisfaction of debt) (Tex. UCC) (Vernon Supp. 1986).

306. 679 S.W.2d 115 (Tex. App.—Dallas 1984, no writ).

307. *Id.* at 117.

308. *Id.* at 119.

309. 691 S.W.2d 768 (Tex. App.—Houston [1st Dist.] 1985, no writ).

310. *Id.* at 770.

311. 628 S.W.2d 769 (Tex. 1982).

312. *Id.* at 771-72.



notice. Because of this distinction the *Piney Point* court held that *Tanenbaum* was thus not a controlling precedent.<sup>313</sup> This decision by the court is highly questionable and essentially restricts *Tanenbaum* to its facts. This result seems inconsistent with the broader reading that the supreme court has ascribed to that case in the later case of *First City Bank v. Guex*.<sup>314</sup> In the opinion of the author, *Piney Point Investment* should be regarded as an aberration and should not be considered a valid interpretation of *Tanenbaum*.

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313. *Id.* at 770.

314. 677 S.W.2d 25, 28 (Tex. 1984).